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SUBJECT: MONTENEGRO FAILS TO RENEW FORMAL IMF AGREEMENT

SENSITIVE BUT UNCLASSIFIED - PLEASE HANDLE ACCORDINGLY

¶1. (SBU) The GoM on May 27 missed its deadline to agree to a new Standby Arrangement agreement with the IMF. As Montenegro is not currently borrowing from the IMF, the failure is not a default, but may be seen by donors, investors and others as a "black mark" on its economic reform program. The failure resulted from a split in the minor coalition partner, the Social Democratic Party (SDP), with a faction of older members rigidly opposing the party leadership. The SDP faction (unlike the SDP leadership) objects to further development of plans to privatize the state-owned electric company, EPCG, and liberalize the very rigid labor market - both elements of the proposed IMF agreement. With the GoM having just 41 seats in the 81-seat parliament, the GoM appears to have concluded that forcing an open split in the SDP could have negatively affected the Government.

¶2. (SBU) The Finance Minister's office told post May 29 that the GoM will continue to regularly file reports with the IMF. Additionally, the GoM-IMF dialogue on Stand-by Arrangements -- the so-called "Article 4" discussions -- will continue. Consequently, a new Stand-by Arrangement may be agreed by the end of the year. Local IMF representative Harold Hirschhofer told post May 25 that the IMF looks to the GoM to maintain its good record on budget discipline (it has been running routine surpluses), agreement or no agreement.

¶3. (SBU) Comment: The IMF's Hirschhofer was clearly disturbed by the inability of the GoM and the SDP to rein in its statist and old-line socialist members, even after a prolonged discussion of the benefits of the now-rejected program. Interventions by the EU and USG with the SDP before the deadline were equally to no avail. At the core of the problem is a GoM and ruling party (the Democratic Party of Socialists - DPS) that has become complacent in its "leadership" role, unwilling or unable to "sell" its more controversial programs - or expecting the international community to take on that role for it. End comment.

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